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No. 94-2084

In The

Supreme Court of the United States

October Term, 1995

MITCHELL W. ADAMS, COMMISSIONER OF REVENUE OF MASSACHUSETTS,

Petitioner,

v.

PERINI CORPORATION, ET AL.,

Respondents.

On Petition For Writ Of Certiorari To The Supreme Judicial Court Of The Commonwealth Of Massachusetts

RESPONDENTS' OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Supreme Judicial Court of the Commonwealth of Massachusetts correctly decided that the Commerce Clause of the United States Constitution renders invalid portions of the Massachusetts corporate excise tax, when those portions of the tax discriminate against interstate commerce by expressly favoring and imposing a lower corporate excise tax on the net worth of Massachusetts parent corporations with Massachusetts subsidiaries, while at the same time imposing a higher corporate excise tax on the net worth of other similarly situated parent corporations doing business in Massachusetts where either the parent corporation or its subsidiary is incorporated outside of Massachusetts.

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RESPONDENTS' STATEMENT OF THE CASE

Introduction

In a decision dated March 22, 1995 and reported at 419 Mass. 763, 647 N.E.2d 52 (1995), the Supreme Judicial Court of the Commonwealth of Massachusetts (the "Supreme Judicial Court") ruled that certain portions of the Massachusetts corporate excise tax (the "excise tax") imposed by Chapter 63 of Mass. Gen. Laws ("G.L.") were unconstitutional under the Commerce Clause of the United States Constitution, art. I, cl. 8. The defendant below, Mitchell W. Adams, Commissioner of Revenue of Massachusetts, has petitioned this Court for a writ of certiorari to review the Supreme Judicial Court's decision. For the reasons set forth herein, the petition for writ of certiorari should be denied.

This case does not meet the Court's standards for certiorari review, first, because the Supreme Judicial Court correctly applied well-established principles of Commerce Clause jurisprudence to strike down the challenged portions of the excise tax. As described below, the excise tax clearly violates the Commerce Clause. The excise tax allows Massachusetts parent corporations with Massachusetts subsidiaries to subtract the value of their investment in those subsidiaries from their "net worth" subject to taxation, but does not allow a similar deduction for Massachusetts corporations with non-Massachusetts subsidiaries, or for non-Massachusetts corporations with Massachusetts subsidiaries. The result is facial discrimination against interstate and foreign commerce based solely on the domicile of the corporation subject to tax or

the domicile of its subsidiaries. According to recent decisions by this Court, as well as a long line of decisions stating established law, such a scheme is invalid for a number of reasons. Even in its petition for certiorari, the petitioner fails to address or attack the several independent reasons why the Supreme Judicial Court found the excise tax to be unconstitutional.

This Court should also reject petitioner's suggestion that it should "postpone action on the petition pending a decision by the Court in *Fulton Corp. v. Faulkner*, No. 94-1239, *cert. granted*, 115 S. Ct. 1689 (1995)." Petition at 6. For various reasons, the *Fulton* case is fundamentally different and does not present the Court with issues that would affect the correctness of the Supreme Judicial Court's decision here. First, *Fulton* involved the different legal analysis that is used in cases involving "compensatory" tax schemes (such as sales and use taxes), and thus its analysis does not apply to this case. The petitioner has never argued that the challenged portions of the excise tax scheme at issue here are part of such a compensatory tax scheme. Second, the "substantial equality" test that petitioner gleans from *Fulton* would be inapplicable in any event because the Supreme Judicial Court found in this case, as a binding interpretation of state law, that the deductions available to domestic and to foreign parents are *not* substantially equal. Third, the Supreme Judicial Court's decision also rests on a finding that the entire excise tax scheme discriminates against interstate commerce, a finding that was not made in *Fulton* and thus would not be touched by any decision in *Fulton*.

Background Facts

The Corporate Excise Tax and Its Impact on Respondents

Each of the respondents, Perini Corporation ("Perini"), Perini Land and Development Corporation ("PL&D"), Dynatech Corporation ("Dynatech"), and Neworld Bancorp, Inc. ("Neworld"), conducts business in Massachusetts and is therefore subject to, and annually pays, the excise tax imposed by G.L. c. 63, including a tax on its "net worth."[1]

Taxable net worth is specifically defined in G.L. c. 63, § 30(8) and § 30(9) to allow corporations organized under the laws of Massachusetts to exclude from their taxable net worth the value of their investment in subsidiary corporations,[2] *but only if* those subsidiaries are also incorporated in Massachusetts. *See* G.L. c. 63, § 30(8). The same exclusion from taxable net worth is *not* available if (i) the parent corporation is incorporated outside of Massachusetts, or (ii) the subsidiary corporation is incorporated outside of Massachusetts.

Moreover, the excise tax statute contains two distinctly different formulas for calculating the "net worth" of domestic corporations and of foreign corporations.

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[1] The statutes at issue impose on "intangible property corporations," including the respondents, a tax of .26% on the corporation's "net worth," as well as a tax on its net income. G.L. c. 63, §§ 32, 39, as modified by c. 63, § 31B and St. 1969, ch. 546, §§ 18 and 21.

[2] The exclusion applies to subsidiaries in which the parent owns 80% or more of the voting stock (hereafter "80% or more owned subsidiaries").

G.L. c. 63, §§ 30(8), (9). The language of these statutory formulas discriminates on its face against interstate commerce in three ways.

First, under the net worth formula that applies to domestic corporations, a Massachusetts corporation may exclude from its taxable net worth the value of its investment in its 80% or more owned *Massachusetts* subsidiaries, but must *include* the value of its investment in its 80% or more owned subsidiaries organized in other states or in other countries. G.L. c. 63, § 30(8). Thus, if a Massachusetts corporation forms or acquires a non-Massachusetts subsidiary, its net worth tax is higher than if it forms or acquires a Massachusetts subsidiary. The net worth formula for domestic corporations is summarized in Exhibit 1 to this brief.

Second, the exclusion of the value of a company's investment in a Massachusetts subsidiary is not available to a foreign parent corporation that pays the excise tax. Under the different net worth formula that applies to foreign corporations pursuant to G.L. c. 63, § 30(9), a foreign corporation cannot exclude the value of its investment in a Massachusetts subsidiary; it can exclude the value of its investment only in 80% or more owned subsidiaries that are non-Massachusetts corporations and do no business in Massachusetts.[3] Under this formula, which is summarized in Exhibit 2 to this brief, a foreign

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[3] G.L. c. 63, § 30(9) does not expressly state that, to be excluded from the ratio calculation, the subsidiary must also be a non-Massachusetts corporation. That additional requirement is, however, imposed by the Department of Revenue. *See* Appendix to the Petition for Certiorari ("Appendix") at A-4.

parent corporation does not get the benefit of the exclusion for 80% owned Massachusetts subsidiaries that is granted to a domestic parent under G.L. c. 63, § 30(8).

Third, the excise tax discriminates not only against foreign parents and domestic parents who choose to acquire foreign subsidiaries, but against interstate commerce itself. Both foreign and domestic parents are penalized for having subsidiaries on the other side of the state's border. If a Massachusetts parent chooses to incorporate a foreign subsidiary, or if a foreign parent chooses to incorporate a domestic subsidiary, there is *no* deduction available.

In this case, because respondents or their subsidiaries are incorporated outside of Massachusetts, they have not been permitted to exclude the value of certain 80% or more owned subsidiaries from their taxable net worth. As a result, respondents have paid and will continue to pay a higher tax than similarly situated Massachusetts corporations with Massachusetts subsidiaries.

Specifically, respondents Perini and Dynatech are Massachusetts corporations with subsidiaries incorporated outside of Massachusetts. Some of the subsidiaries do business in Massachusetts, and as such they must also pay the annual corporate excise. Under the terms of § 30(8), Perini and Dynatech have not been able to exclude from their taxable net worth the value of their foreign subsidiaries. *See* Appendix at A-4.

The two other plaintiffs, PL&D and Neworld, are both foreign corporations each of which wholly owns a Massachusetts subsidiary. Because PL&D and Neworld are foreign corporations, neither corporation has been

able to exclude from its taxable net worth the value of its Massachusetts subsidiary. *See* Appendix at A-4.

The Supreme Judicial Court's Decision

The Supreme Judicial Court ruled that the challenged provisions of the excise tax, G.L. c. 63, § 30(8) and § 30(9), violated the Commerce Clause.

The Supreme Judicial Court first considered whether the excise has a sufficient effect on interstate commerce to evoke Commerce Clause scrutiny. The Court held that:

> [t]he flow of value between the plaintiffs and their foreign subsidiaries clearly constitutes interstate commerce. This flow includes not only the acquisition of foreign subsidiaries, but also the flow of dividends, employee benefits, insurance, and other services from parent corporations to their subsidiaries.

Appendix at A-5. (Petitioner has not questioned and does not raise this conclusion as an issue for this Court.)

The court then turned to the question whether the challenged provisions are unconstitutional under the Commerce Clause. Citing this Court's recent decision in *Oregon Waste Systems, Inc. v. Department of Envtl. Quality*, 114 S. Ct. 1345 (1994), the Supreme Judicial Court correctly noted that a state statute is invalid under the Commerce Clause if it discriminates against interstate commerce. Appendix at A-5. The Supreme Judicial Court quoted *Oregon Waste* in stating that "[t]he term 'discrimination' as used in this context means 'differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter,' " and that

" '[i]f a restriction on commerce is discriminatory, it is virtually *per se* invalid.' " Appendix at A-5, quoting 114 S. Ct. at 1349.

Applying these principles, which have been reconfirmed by this Court on several occasions in recent terms, the Supreme Judicial Court ruled that "the challenged provisions of the corporate excise facially discriminate against interstate commerce." Appendix at A-6. The excise tax created "facial" discrimination because it distinguishes, by its very terms, between different corporations "solely on the basis of the domicil of the subsidiary." *Id.* Section 30(8) "treats a domestic corporation more favorably if it chooses to acquire a domestic subsidiary, rather than a foreign subsidiary." *Id.* Section 30(9) "also treat[s] foreign parent corporations less favorably than similarly situated domestic parent corporations." *Id.* at A-7.

The Supreme Judicial Court identified several ways in which these provisions discriminate against and impact interstate commerce. First, "the statutory scheme imposes a heavier burden on domestic corporations who own *foreign* subsidiaries than on domestic corporations who own *domestic* subsidiaries." Appendix at A-6, citing *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin.*, 112 S. Ct. 2365, 2372 (1992).

Second, "[t]he challenged deductions also create an incentive for domestic corporations to acquire in-State subsidiaries, and penalize corporations that choose to cross State lines." *Id.* Citing *Healy v. The Beer Institute Inc.*, 491 U.S. 324 (1989), the Supreme Judicial Court found

that "the deductions at issue create a substantial disincentive for domestic parent corporations to engage in interstate commerce." Appendix at A-7.

Third, "[t]he challenged provisions also treat foreign parent corporations less favorably than similarly situated domestic parent corporations." Appendix at A-7. The differential treatment arises because, "[a]lthough the domestic corporation would be entitled to deduct the value of its subsidiary, the foreign corporation would not." *Id.*, citing *West Lynn Creamery, Inc. v. Healy*, 114 S. Ct. 2205, 2212, 2214 (1994).

The Supreme Judicial Court next rejected the petitioner's argument, made anew here, that the excise tax does not violate the Commerce Clause because it gives domestic and foreign corporations "substantially equal but not identical deductions." *See* Petition for Certiorari at 6. This argument failed to persuade the court, first, because the deductions available to the two types of corporation *were not* in fact substantially equal. "[B]ecause the net worth formulas for domestic and foreign corporations differ, the deduction given to a foreign corporation for a matching subsidiary is *less favorable* than that given to a domestic corporation." Appendix at A-7 to A-8 (emphasis added). Second, "even assuming that the deductions given for matching subsidiaries are substantially equal, the statute as a whole still places an impermissible burden on interstate commerce." *Id.* at A-8. The reason for this is simple:

> Under § 30(8) and (9), only those corporate structures which are exclusively domestic or exclusively foreign are given a deduction. Once a domestic corporation acquires a subsidiary

> outside of its home State, and regardless of whether that subsidiary does business in Massachusetts, the parent corporation must include the value of that subsidiary in its net worth calculation. Thus, the effect of this taxing scheme is to encourage single-State corporate structures and to penalize parent corporations that choose to cross State lines in order to acquire or create foreign subsidiaries.

Appendix at A-8.

The Supreme Judicial Court went on to hold that the discrimination created by the excise tax is "*further* demonstrated by applying the so-called 'internal consistency test.' " Appendix at A-8 (emphasis added). The court applied the well-established statement of that test from *Armco Inc. v. Hardesty*, 467 U.S. 638, 644 (1984). "[A] tax must have 'what might be called internal consistency – that is the [tax] must be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade." Appendix at A-8 (citations omitted). The court stated:

> Clearly, if every State applied a similar excise, the acquisition of foreign subsidiaries would be reduced and multi-State corporate structures would be significantly burdened. Such a scheme clearly interferes with free trade among the States and cannot be considered consistent with the commerce clause.

Id.

Finally, in a portion of the decision below which the petitioner does not contest here, the Court found that the petitioner could not meet his burden of demonstrating

that the discriminatory provisions of the excise tax advance a legitimate local purpose that "cannot be adequately served by reasonable nondiscriminatory alternatives." Appendix at A-9, citing *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988). The petitioner's proffered justification for the statute – that it prevents double taxation – did not justify the discrimination. As the court put it:

> Although we agree that preventing double taxation is a legitimate local purpose, § 30(8) and (9) are not narrowly tailored to serve that interest. The excise deductions only prevent double taxation for Massachusetts corporations which own Massachusetts subsidiaries. All subsidiaries that do business in Massachusetts, regardless of their State of incorporation, however, are subject to the annual corporate excise. Thus, although double taxation is avoided for Massachusetts corporations which own only Massachusetts subsidiaries, the problem of double taxation persist for multi-State corporate families. In light of this fact, we conclude that the challenged provisions do not significantly advance the legitimate State interest in avoiding double taxation, and thus, cannot withstand scrutiny.

Appendix at A-9.[4]

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[4] Respondents also argued below that the excise tax is invalid under the Equal Protection Clause of the United States Constitution, Amendment XIV, § 1. Because of its ruling on Commerce Clause grounds, the Supreme Judicial Court did not reach this issue. Appendix at A-10.

REASONS WHY THE WRIT SHOULD BE DENIED

As set forth below, the principal reason not to grant certiorari in this case is that the Supreme Judicial Court correctly applied well-established principles of Commerce Clause jurisprudence to strike down a tax scheme that is facially discriminatory and invalid. The excise tax statute distinguishes between domestic and foreign corporations in a way that creates an obvious discriminatory impact on interstate commerce in several different ways. The Supreme Judicial Court also correctly applied, as "further" evidence of the unconstitutionality of the excise tax, the "internal consistency test" under the Commerce Clause. Put simply, the Supreme Judicial Court's decision, although it involves a constitutional issue, raises no novel questions or law, nor does it create any error or work any injustice that calls for review by this Court.

Petitioner argues that this case should be held pending a decision by this Court in *Fulton Corp. v. Faulkner*, No. 94-1239, *cert. granted*, 115 S. Ct. 1689 (1995), because the decision below may conflict with whatever decision this Court reaches in *Fulton*. *See* Petition at 6. As will be shown below, however, *Fulton* is clearly inapplicable to this case and, regardless of how it is decided, will not change the fact that the Supreme Judicial Court applied the right analysis and reached the correct conclusion in this case. Indeed, the "substantial equality" test referenced in *Fulton* and relied upon by petitioner is inapplicable to this case because this case, unlike *Fulton*, does not involve a compensatory tax scheme. Moreover, the "substantial equality" test that petitioner contends is supported by *Fulton* would not apply to this case in any event because the Supreme Judicial Court found, as a

binding interpretation of state law, that the deductions available under § 30(8) and § 30(9) are not substantially equal. The decision below also rests upon a finding of discrimination against interstate commerce that was not made in *Fulton*, which finding provides an independent basis for the court's decision that would not be touched by *Fulton*. Thus, regardless of the outcome in *Fulton*, there is no reason to believe that this Court will reverse or revise the well-established constitutional principles that completely support the Supreme Judicial Court's decision.

I. THE SUPREME JUDICIAL COURT APPLIED WELL-ESTABLISHED LAW IN CORRECTLY RULING THAT THE EXCISE TAX VIOLATES THE COMMERCE CLAUSE.

A. The Excise Tax Discriminates Against and Burdens Interstate Commerce.

The Supreme Judicial Court correctly ruled that the excise tax violates the Commerce Clause because it discriminates on its face between Massachusetts corporations and foreign corporations with corporate subsidiaries. The challenged portions of the excise tax discriminate against interstate commerce in several obvious ways.

First, by allowing Massachusetts parent corporations to exclude from their taxable net worth the value of only those subsidiaries that are also Massachusetts corporations, *see* G.L. c. 63, § 30(8), the statute expressly imposes a higher tax on certain domestic corporations, including Perini and Dynatech, simply because they have foreign

rather than Massachusetts subsidiaries.[5] The imposition of a greater tax burden on Massachusetts parent corporations as a result of their subsidiaries' foreign domicile affects the decisions of domestic corporations with respect to the corporate structure of their subsidiaries. This portion of the excise tax creates an incentive for Massachusetts corporations to create or purchase only Massachusetts subsidiaries. It imposes an extra cost on Massachusetts corporations which, like Perini, establish or, like Dynatech, acquire foreign subsidiaries. Such an incentive expressly favors local economic interests over interstate commerce.

Second, by allowing Massachusetts parent corporations to exclude the value of Massachusetts subsidiaries from their net worth, but not allowing foreign parent corporations the same exclusion, *see* G.L. c. 63, § 30(9), the statute expressly imposes a different and greater excise tax on foreign parent corporations with Massachusetts subsidiaries, such as Neworld and PL&D, by denying them a deduction that is given to similarly situated domestic parent corporations. This aspect of the excise tax directly discriminates against foreign parent corporations simply by virtue of their state of incorporation.

Thus the tax penalizes plaintiffs and other corporations with subsidiaries where both parent and subsidiary are not incorporated in Massachusetts. It encourages

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[5] The statute explicitly draws a distinction based solely on domicile. It does not turn on the characteristics or behavior of the subsidiary or, for example, where it pays taxes. Even if the subsidiary, like PL&D, does business in Massachusetts and itself pays the net worth tax here, its parent is denied the deduction.

multi-corporate families to stay entirely inside or entirely outside of Massachusetts, penalizing those incorporated on both sides of the border, and discouraging multi-state business.[6]

This case does not involve a mere potential or theoretical impact. As foreign corporations with Massachusetts subsidiaries, plaintiffs Neworld and PL&D pay a greater tax – just because of their foreign incorporation – than they would if they could deduct the value of their Massachusetts subsidiaries. If Neworld had changed its state of incorporation to Massachusetts, it would not have been taxed on the value of its interest in its subsidiary. As Massachusetts corporations that own subsidiaries in numerous states other than Massachusetts, plaintiffs Perini and Dynatech are also disadvantaged. Each pays a greater tax – just because of the foreign incorporation of its subsidiaries – than it would if it incorporated those subsidiaries in Massachusetts.

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[6] Petitioner does not contest the Supreme Judicial Court's correct conclusion that the excise tax imposes a burden on interstate and foreign commerce. This Court has ruled that the flow of resources and money between corporate parents and their subsidiaries, as well as the parents' provision of centralized financial, accounting and other services, is interstate commerce. *See, e.g., Kraft General Foods, Inc. v. Iowa Dept. of Rev.*, 112 S. Ct. 2365, 2369 (1992) ("[t]he flow of value between Kraft and its foreign subsidiaries clearly constitutes foreign commerce; this flow includes the foreign subsidiary dividends, which . . . themselves constitute foreign commerce"); *North American Co. v. SEC*, 327 U.S. 686, 694 (1946) (holding company's provision to subsidiaries of advisory and consultative facilities and its relationships and contacts with subsidiaries constitute interstate commerce).

B. Numerous Supreme Court Decisions Establish That The Challenged Portions of the Excise Tax Are Invalid as a Matter of Law.

The Supreme Court has consistently held such facial discrimination is virtually invalid *per se*. Although many cases have addressed Commerce Clause issues in varying, often complex, situations, the rule applicable to this case is simple: "If a restriction on commerce is discriminatory, it is virtually per se invalid." *Oregon Waste Systems, Inc. v. Department of Envt'l. Quality*, 114 S. Ct. 1345, 1350 (1994); *see also Associated Industries of Missouri v. Lohman*, 114 S. Ct. 1815, 1820 (1994) ("a 'virtually *per se* rule of invalidity' [applies] to provisions that patently discriminate against interstate trade"); *West Lynn Creamery, Inc. v. Healy*, 114 S. Ct. 2205, 2211 (1994) (same). Moreover, plaintiffs need not show an anti-competitive motive or purpose; a discriminatory effect is enough to invalidate the law. *See, e.g., City of Philadelphia v. New Jersey*, 437 U.S. 617, 626-27 (1978). The Commerce Clause was designed to prohibit individual state laws favoring "local enterprises at the expense of out-of-state businesses," *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329 (1977), and to avoid the imposition of "artificial rigidity on the economic pattern" of industry, *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 406 (1984) (quoting *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 146 (1970)). "When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry." *Brown-Forman Distillers Corp. v. N.Y.*

State Liquor Authority, 476 U.S. 573, 579 (1986) (collecting authorities).

Here, as demonstrated above, the excise tax discriminates against interstate commerce on its face, and the discrimination has a clear, substantial impact. Each of the discriminatory characteristics of the excise tax is enough to invalidate the tax "without further inquiry." *Brown-Forman Distillers*, 476 U.S. at 579.[7]

In the 1993 Term, this Court reaffirmed and strengthened its firm view that discrimination between domestic and foreign companies on the face of a state statute renders that statute invalid. In *Oregon Waste Systems*, 114 S. Ct. at 1350-51, the Court not only noted that a discriminatory statute "is virtually per se invalid," but emphasized that the statute's purpose or justification "has no bearing on whether it is facially discriminatory." Applying the "strictest scrutiny," the Court then refused to credit the state's argument that the challenged statute was meant to compensate for other factors that might

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[7] The invalidity of the excise tax is also evident because, by taxing similarly situated corporations differently based upon their domicile or their subsidiary's domicile, the tax "forecloses tax-neutral decisions and creates both an advantage for [Massachusetts parents] and a discriminatory burden on commerce to . . . sister States." *Boston Stock Exchange*, 429 U.S. at 331; *see also Westinghouse Electric*, 466 U.S. at 406. This Court has held repeatedly that a statute violates the Commerce Clause when it has the intent or effect of "induc[ing] 'business operations to be performed in the home State that could more efficiently be performed elsewhere.' " *Westinghouse Electric*, 466 U.S. at 406 (quoting *Boston Stock Exchange*, 429 U.S. at 336).

impose greater burdens on domestic corporations. *Id.* at 1351-55.

Several of this Court's recent cases have invalidated state taxes similar in structure to the excise tax provisions here. For example, the excise tax is similar to the New York tax credit that was ruled invalid in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984). There, the state created a franchise tax credit for certain income of Domestic International Sales Corporations ("DISCs"). The credit allowed a parent corporation a larger tax credit on its accumulated DISC income to the extent its subsidiary DISC performed more of its shipping activities within New York. *Id.* at 400. The credit thus had "the effect of treating differently parent corporations that are similarly situated in all respects except for the percentage of their [subsidiary's] shipping activities conducted from New York." *Id.* The unanimous Court found this "direct commercial advantage to local business" unconstitutional under the Commerce Clause. *Id.* at 403.

The discrimination in the excise tax is essentially identical to the distinction struck down in *Kraft General Foods, Inc. v. Iowa Dept. of Revenue*, 112 S. Ct. 2365 (1992). There, the challenged state income tax allowed parent corporations to deduct dividends received from domestic subsidiaries, but not from subsidiaries incorporated in foreign countries. The Court used a *per se* analysis to reject outright this facially discriminatory deduction under the Foreign Commerce Clause. *Id.* at 2372. The Court held that a state may not "force a taxpayer to conduct its foreign business through a domestic subsidiary in order to avoid discriminatory taxation of foreign commerce." *Id.* at 2369-70. The excise tax here, exactly

like the statute invalidated in *Kraft*, impermissibly pressures foreign corporations to incorporate in Massachusetts.[8]

C. The Supreme Judicial Court Did Not Misapply the Internal Consistency Test.

Petitioner is clearly wrong to assert that the Supreme Judicial Court misapplied the internal consistency test, which measures whether a state tax statute discriminates against interstate commerce. *See Tyler Pipe Indus. Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 246-47 (1987); *Armco v. Hardesty*, 467 U.S. 639, 644-45 (1984). The test itself is well established, and was correctly recited by the Supreme Judicial Court:

> [A] tax must have 'what might be called internal consistency – that is the [tax] must be such that, if applied by every jurisdiction,' there would be no impermissible interference with free trade.

Armco, 467 U.S. at 644 (quoting *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983). *See* Appendix at A-8. Put another way, the internal consistency test "simply looks to the structure of the tax at issue to see

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[8] Other Commerce Clause cases have also invalidated statutes quite similar to the Massachusetts excise tax. In *Healy v. The Beer Institute, Inc.*, 491 U.S. 324, 341 (1989), the statute created a disincentive for in-state brewers to sell in neighboring states and for out-of-state brewers to sell in-state; multi-state operations were burdened compared to those entirely within the state or entirely outside it. In *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1980), the Court invalidated a statute that barred an out-of-state parent holding company from establishing a subsidiary within the state.

whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 115 S. Ct. 1331, 1338 (1995).

The Supreme Judicial Court's application of the internal consistency test in this case was proper.[9] Here, the foreign corporations which are subject to the excise tax also pay taxes to other states where they are incorporated or do business. If every state had a similar excise tax, every state would be imposing a greater tax on foreign corporations than on domestic corporations, and a greater tax on domestic corporations with foreign subsidiaries, thus discouraging companies from doing business in more than one state.

To show how the internal consistency test is violated in this case, consider the example of Perini. Perini, a Massachusetts parent, does not get the deduction in Massachusetts for the value of its Delaware subsidiary PL&D. If every state, including Delaware, adopted the same tax system, Perini would not get the deduction in Delaware either (as a foreign parent with a domestic subsidiary, from Delaware's point of view). Corporate families like the plaintiffs that cross state boundaries would be denied the deduction in *both* the state of the parent's domicile and the state of the subsidiary's domicile. This would result in precisely the multiple taxation and consequent

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[9] As noted earlier, the Supreme Judicial Court used the internal consistency test as an *independent* basis for finding the excise tax invalid, and as "further" evidence that the tax was discriminatory. Appendix at A-8.

overburdening of interstate commerce which the internal consistency test requires the states to avoid.

Petitioner asserts that the "crucial question in this case" is "whether the deductions *considered together* violate the internal consistency test." Petition at 10. According to petitioner, the Supreme Judicial Court "failed to review the domestic-domestic deduction 'in light of its actual effect considered *in conjunction with other provisions* of the State's tax scheme.' " *Id.*, quoting *Maryland v. Louisiana*, 451 U.S. 725, 756 (1981). Petitioner is wrong. The Supreme Judicial Court clearly considered the impact of *both* the foreign-foreign and domestic-domestic deductions when it stated that "the effect of this taxing scheme is to encourage single-State corporate structures and to penalize parent corporations that choose to cross State lines in order to acquire or create foreign subsidiaries." Appendix at A-8. This "balkanization" of corporate structures, with its direct impact on interstate commerce, is an impact of the excise tax scheme taken as a whole, and is precisely one type of evil that the internal consistency test was designed to identify and eliminate.[10]

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[10] The decision below was correct for a third reason as well. Petitioner does not contest the Supreme Judicial Court's conclusion that the challenged excise tax provisions are not properly supported by any legitimate government interest. It is undisputed that a legitimate – even a significant – governmental interest will not justify discrimination against foreign corporations or against interstate commerce itself. *West Lynn Creamery*, 114 S. Ct. at 2217-18. Rather, a facially discriminatory statute may only survive if the state demonstrates a "*compelling* justification," *Kraft*, 112 S. Ct. at 2371, and shows that the state's purposes "cannot be adequately served by reasonable nondiscriminatory alternatives," *New Energy Co. of Indiana v. Lim-*

II. THERE IS NO REASON TO HOLD THIS CASE FOR *FULTON CORP. v. FAULKNER*, NO. 94-1239, AS THAT CASE IS FUNDAMENTALLY DIFFERENT AND, REGARDLESS OF THE RESULT REACHED IN THAT CASE, THE SUPREME JUDICIAL COURT'S DECISION IN THIS CASE IS STILL CORRECT.

Finally, there is no merit to the petitioner's assertion that this Court should postpone consideration on this petition pending a decision by the Court in *Fulton*. As discussed below, even if the Court were to reverse *Fulton*, the decision would not change the result in the present case.[11]

A. The "Substantially Equal" Test That Was Applied to the Compensatory Tax Scheme in *Fulton* Is Not Applicable Here.

This case should not be granted or held pending the outcome of *Fulton* because, contrary to petitioner's contention, there is no conflict between the present case and *Fulton*.

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bach, 486 U.S. 269, 278 (1988). A discriminatory statute must "pass the 'strictest scrutiny.' " *Oregon Waste Systems*, 114 S. Ct. at 1351. Petitioner has not even asserted that this test is met; for the reasons stated by the Supreme Judicial Court, it is not.

[11] A motion has been filed in *Fulton* to dismiss the case on the grounds that certiorari was improvidently granted. According to that motion, the statutory scheme at issue in *Fulton* has been repealed and, accordingly, the need for review has been greatly reduced. *See* Respondent's Motion to Dismiss the Writ of Certiorari as Improvidently Granted, in No. 94-1239, filed June 13, 1995.

Fulton differs fundamentally from this case because, there, the North Carolina Supreme Court was considering a "compensatory tax scheme," and was applying the distinct legal analysis used to analyze such a scheme. The unique tax scheme at issue in *Fulton* allowed a corporate owner of stock a deduction from the intangible property tax that was otherwise imposed on the value of the stock. The amount of the deduction varied depending upon the percentage of the issuing corporation's income that was taxable in the state: "[T]he greater the percentage of the issuing corporation's total income which is allocated to and taxed in this state, the more dividend income from that corporation a corporate shareholder is allowed to deduct and the less intangibles tax the shareholder pays." *Fulton Corp. v. Justus*, 450 S.E.2d 728, 730 (N.C. 1994), *cert. granted sub nom. Fulton Corp. v. Faulkner*, No. 94-1239, 115 S. Ct. 1689 (1995). The court treated this tax scheme as a "compensatory tax scheme" because the deduction in a property tax on intangibles was designed and intended to compensate and offset the higher income taxes paid by corporations doing business within the state. *Id.* at 731. As a result, the court adopted the legal analysis commonly used for compensatory tax schemes, such as sales and use taxes. It found the tax scheme to be consistent with the Commerce Clause because, according to the court's findings, the tax scheme "impose[d] on interstate commerce the rough equivalent of an identifiable and 'substantially similar' tax on intrastate commerce." *Id.*

This case, in contrast, does *not* involve a compensatory tax scheme. The petitioner has never argued that the differential treatment of domestic and foreign corporations under the excise tax is justified by an effort "to

make interstate commerce bear a burden already borne by intrastate commerce," *Associated Indus. of Missouri v. Lohman*, 114 S. Ct. 1814, 1821 (1994), which is the crux of a compensatory scheme. Rather, the petitioner's only justifications for the discriminatory excise tax were that (i) § 30(8) was designed to avoid double taxation of domestic corporations, and (ii) § 30(9) was somehow a recognition of limitations on the Commonwealth's ability to tax foreign corporations which do no business in Massachusetts. *See* Appendix A-9 & n.8. Thus, petitioner has not met, and cannot meet, its threshold burden of identifying the burden on intrastate tax for which the Commonwealth is attempting to compensate. *Oregon Waste Systems*, 114 S. Ct. at 1352.

Indeed, it would make no sense to adopt a compensatory tax analysis in this case. This is clearly not a typical compensatory tax situation, where foreign corporations or companies doing business in interstate commerce would have a lower tax burden were it not for the compensatory tax. Here, all corporations doing business in Massachusetts are subject to the excise tax – including foreign corporations and those doing business in interstate commerce. The discriminatory scheme at issue here imposes a *greater* burden, and a *higher* tax on foreign corporations and on domestic parents with foreign subsidiaries.

The failure to identify the specific compensatory element of this tax scheme is "fatal" to a compensatory tax argument. *Oregon Waste Systems*, 114 S. Ct. at 1352-53. There is therefore no sound legal basis for petitioner's contention that a "substantial equality" test should apply and that this case should be held for *Fulton*. *See also*

Oregon Waste Systems, 114 S. Ct. at 1353 (noting this Court's "reluctance to recognize new categories of compensatory taxes"). Rather, this is a case of simple, obvious and direct discrimination against interstate commerce. The appropriate analysis to be applied in this case is clearly different from the analysis used in *Fulton*. *See, e.g., id.* at 1350 (discriminatory statute is "virtually per se invalid"); *Associated Industries of Missouri*, 114 S. Ct. at 1820 (same).[12]

B. Petitioner's Argument Ignores the Fact that the Supreme Judicial Court Ruled that the Deductions Were Not Substantially Equal.

A second conclusive reason why *Fulton* is inapplicable to this case is that the Supreme Judicial Court found – as a binding interpretation of state law – that the two deductions are *not* substantially equal. Appendix at A-8. As a result, even if petitioner were right that the standard of *Fulton* ought to apply to this case, petitioner could not meet that standard.

In its brief below, petitioner's principal argument was that the excise tax does not discriminate between domestic and foreign taxpayers, because "at the taxpayer

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[12] This Court's 1912 decision in *Darnell v. Indiana*, 226 U.S. 390 (1912), upon which the North Carolina Supreme Court relied, is also inapplicable for similar reasons. The decision in *Darnell* was a precursor to more recent compensatory tax decisions. There is nothing in *Darnell* which provides any basis for rejecting the Supreme Judicial Court's correct decision to treat this case as a non-compensatory tax scheme that is facially discriminatory.

level, domestic and foreign companies are treated equally, because each may deduct the value of matching subsidiaries." Brief of Appellee at 17. The Supreme Judicial Court correctly rejected this argument, which petitioner is repeating here under another guise, for several reasons.

For one thing, the whole idea of "matching deductions" (and hence "equal treatment") is patently false because *foreign and domestic corporations do not get the same deduction*. This is *not* a case in which both foreign and domestic corporations are allowed to deduct the value of Massachusetts subsidiaries, or where both are allowed to deduct the value of foreign subsidiaries. Instead, foreign and domestic parents get *different* deductions.

As to those different deductions, the notion that the domestic-domestic deduction "matches" the foreign-foreign deduction is superficially appealing, but it is clearly wrong. The supposedly "matching" deductions available to domestic and foreign parents are *not* "substantially equal." G.L. c. 63, § 30(8) and § 30(9) contain two completely different formulas for calculating the net worth of domestic and foreign corporations. *See* Exhibits 1 and 2 hereto. These different formulas give less to the foreign corporation in two ways: (1) A domestic corporation is allowed to deduct the value of *all* Massachusetts subsidiaries, regardless of where they do business. In contrast, a foreign corporation can deduct the value of only *some* foreign subsidiaries: those that do no business in Massachusetts. Appendix at A-4. (2) Because the mathematical formulas are different, the value of the deduction, even when it is available, will often be less for a foreign parent. For both reasons, the apparently similar deductions given

to foreign and domestic parents lead to less favorable tax results for the foreign corporation.

Thus, although petitioner now tries to revive its suggestion that the two deductions are somehow "substantially equal," in fact they are not. *See Oregon Waste*, 114 S. Ct. at 1352 (for taxes to be "substantially equivalent," the events on which the tax is imposed "must be sufficiently similar in substance to serve as mutually exclusive 'proxies' for each other"). The Supreme Judicial Court's conclusion that the deductions are not equal is a binding interpretation of state law that is not reviewable by this Court. *See Wisconsin v. Mitchell*, 113 S. Ct. 2194, 2198 (1993). At a minimum, it makes no sense to take this case on certiorari to consider the applicability of the "substantially equal" test, when the Supreme Judicial Court's rejection of the factual predicate for that test is so obviously correct.[13]

C. The Supreme Judicial Court's Finding Of Discrimination Is Correct Even If It is Assumed That the Deductions are "Substantially Equal."

Finally, and even more fundamentally, this case should not be held for *Fulton* because the Supreme

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[13] Petitioner asserts that the Supreme Judicial Court's use of the term "less favorable" to describe the obvious inequality between the deductions was tantamount to requiring that "tax treatment be identical." Petition at 8. It could not be clearer, however, that the Supreme Judicial Court's finding that the facially discriminatory nature of the statute itself, together with the obviously greater burden on foreign corporations, makes the two deductions substantially *un*-equal.

Judicial Court invalidated the excise tax for reasons that are not at issue in *Fulton*.

In particular, the Supreme Judicial Court ruled that the challenged portions of the excise tax are invalid *even if it is assumed that the matching deductions are considered to be "substantially equal."*

> [E]ven assuming that the deductions given for matching subsidiaries are substantially equal, the statute as a whole still places an impermissible burden on interstate commerce. Under § 30(8) and (9), only those corporate structures which are exclusively domestic or exclusively foreign are given a deduction. Once a domestic corporation acquires a subsidiary outside of its home State, and regardless of whether that subsidiary does business in Massachusetts, the parent corporation must include the value of that subsidiary in its net worth calculation. Thus, the effect of this taxing scheme is to encourage single-State corporate structures and to penalize parent corporations that choose to cross State lines in order to acquire or create foreign subsidiaries.

Appendix at A-8.

Application of the "substantial equality" test to this case would not touch the Court's finding that the statutory scheme as a whole is invalid because *the excise tax scheme penalizes all corporations that choose to cross state lines and adopt domestic-foreign or foreign-domestic corporate structures.* Even if domestic and foreign parents were burdened by an *identical* limitation that penalized *each* taxpayer operating interstate, the statutes in this case would be invalid. Corporations like plaintiffs that have

engaged in interstate commerce by adopting an interstate corporate structure are facially discriminated against because they get no deduction at all.[14]

The type of discrimination involved in this case is precisely what the Commerce Clause was intended to protect against. It is axiomatic that a state "may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." *Armco*, 467 U.S. at 642. The petitioner's argument that the excise tax at issue here is valid flies in the face of Supreme Court decisions such as *Westinghouse Electric Corp., supra* (invalidating franchise tax credit which treated parent corporations differently depending upon level of business done in state), and *Kraft General Foods, supra* (striking down tax deduction that distinguished between foreign and domestic subsidiaries), which have rejected discriminatory schemes very similar to the excise tax here. The discrimination against foreign parents with domestic subsidiaries and domestic parents with foreign subsidiaries present in this case is exactly parallel to the discrimination struck down in *Tyler Pipe Industries v. Department of Revenue*, 483 U.S. 232, 246 (1987), and *Healy v. The Beer Institute*, 491 U.S. 324, 341 (1989) (statute

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[14] Indeed, in its brief to the Supreme Judicial Court, the petitioner *conceded* one half of this problem: that, notwithstanding the "matching deductions," the excise tax has an adverse effect on one kind of interstate commerce, creating an "incentive [for a foreign corporation] to incorporate and operate subsidiaries *outside* Massachusetts." Appellee's Brief at 27 (emphasis in original). That is, the statute creates a special *dis*incentive for foreign corporations to cross state borders and incorporate and operate subsidiaries in Massachusetts. This concession alone proves that the statute is discriminatory and unconstitutional.

"[penalizes] Connecticut brewers if they seek border-state markets and out-of-state shippers if they choose to sell both in Connecticut and in a border State"). The petitioner does not even cite these cases, much less distinguish them.

Thus, should this Court rule in *Fulton* that a "substantial equality" test is valid, and even if such a test applied to the two non-compensatory excise tax deductions at issue in this case, the Supreme Judicial Court's decision still would not be subject to reversal because it found invalid discrimination against interstate commerce from the entire statutory scheme.

CONCLUSION

For the foregoing reasons, respondent respectfully requests that this Court deny the petition for writ of certiorari in this case.

Respectfully submitted,

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G.L. c. 63, §30 (8)

NET WORTH OF A MASSACHUSETTS CORPORATION

Apportionment % = [**Book Value of Total Assets** — (**Liabilities**) — [**Book Value of Tangible Property in Massachusetts Subject to Property Tax, Less Mortgagee's Interest**] — [**Book Value of Investments in Massachusetts Subsidiaries That Are More Than 80% Owned**]]

G.L. c. 63, §30 (9)

NET WORTH OF A FOREIGN CORPORATION

$$\left[\text{Book Value of Total Assets} - \text{Liabilities}\right] \times \left[\frac{\text{Tangible Assets Within Massachusetts and Not Subject to Local Tax} + \text{Apportionment \%} \left[\text{Total Intangible Assets} - \text{Book Value of Investments in 80\% Subsidiary Corporations Not Doing Business in Massachusetts and Incorporated Outside of Massachusetts}\right]}{\text{Book Value of Total Assets}}\right]$$